1	2 A	2 B	2 C	3
4. United India Airways		3 F-50 (50)	—	Permitted on 10.3.1997
5. Gujarat Airways	4 Beechcraft (19) 1900D	1 Beechcraft (19) 1900D	—	Permitted on 21.8.1997 Operating scheduled srevices on ad-hoc basis.

Frauds Committed By the NBFCs

961. SHRI GHUFRAN AZAM: Will the Minister of FINANCE be pleased to state:

(a) whether the task force set up by Government on Non Banking Finance Companies (NBFCs) has recommended sweeping changes in regulation and operation of these companies;

(b) if so, the details thereof;

(c) the details of frauds committed by NBFCs in the country during the last three years; and

(d) the action contemplated by Government against them as per laws?

THE MINISTER OF STATE IN THE MINISTRY OF FINANCE (BANKING, REVENUE AND INSURANCE) (SHRI KADAMBUR M.R. JANARTHANAN): (a) and (b) The Task Force on Non Banking Finance Companies (NBFCs) has submitted its report to Government in October, 1998. Copies of the report have been placed in the Parliament Library. A number of changes in regulatory framework for NBFCs have been recommended by the Task Force.

A summary of recommendations is given in the Statement. (*See* below)

(c) and (d) Upto October 31, 1998 Prohibitory orders have been issued by Reserve Bank of India (RBI) in respect of 266 problem NBFCs. A Prohibitory Order is normally issued by RBI to a NBFC on occurrence of defaults in repayment of matured deposits/payment of interest on deposits or where the company is found to be insolvent, jeopardising the interests of depositors. Further, according to RBI they have taken additional action against erring NBFCs against whom a large number of complaints regarding non-payment of deposits were received and on inspection, the companies were found to be insolvent. Accordingly, RBI have filed winding up petitions in the respective High Courts in the case of CRB Capital Markets Ltd., New Delhi, JVG Group of companies, New Delhi and Asia Pacific Investment Trust Ltd., Hyderabad. RBI have also launched prosecution proceedings in respect of JVG Finance Ltd., New Delhi, JVG Leasing Ltd., New Delhi, JVG Securities Ltd., New Delhi, Hoffland Finance Ltd., New Delhi, Asia Pacific Investment Trust Ltd., Hyderabad, NITL Mutual Benefits Ltd., New Delhi, Endowment Investment (I) Ltd., Chandigarh and Rockland Leasing Ltd., New Delhi. In addition RBI have filed a police complaint for cheating the public under section 420 of IPC against Hoffland Finance Ltd., New Delhi.

RBI has been taking various steps to effectively montior NBFCs.

Statement

Summary of the Recommendations

1. Diversification of financial markets is an important component of finanical sector reforms. In this environment, NBFCs have flourished and have become prominent in a wide range of activities like hire purchase finance, housing

finance, equipment leasing finance, loans and investments.

2. It is recognised that the existing legislative and regulatory framework requires further refinement and improvement because of the rising number of defaulting NBFCs and the need for an efficient and quick system for redressal of grievances of individual depositors. The procedure for taking over the assets and liquidation of defaulting and insolvent NBFCs remains deficient and is neither able to effectively prevent asset stripping nor does it enable quick disposal of assets for the benefit of all creditors whether secured or unsecured. There is also the perception that the regulatory regime in some respects is over restrictive and has constrained the grwoth of well performing healthy NBFCs.

3. The three year period for attaining minimum NOF would expire in January, 2000. Any extension granted by the RBI should be made conditional upon the concerned NBFC having taken adequate steps to increase NOF in the initial three year period and satisfactory arrangements to attain the minimum capital requirement as may be applicable at that point of time within the extended period. Further, the present minimum capital requirement of Rs. 25 lacs itself may have to be reviewed upward keeping in view the need to impart greater financial soundness and achieve economies of scale in terms of efficiency of operations and higher managerial skills.

4. It would be necessary for the RBI to draw up a time bound programme for disposal of applications for registration as an NBFC. Given the fact that the operations of NBFCs are often concentrated in far flung areas, the RBI may apprise the State Governments of the companies which have been granted registration as well as the companies whose applications have been rejected.

5. Given the relatively higher risk involved in NBFCs' operations, a higher level of CRAR compared to banks is essential. While the present stipulation of 12% of CRAR for all rated NBFCs may continue, the RBI may prescribe a higher CRAR of say 15% for those NBFCs which seek public deposit without credit rating.

6. It is also necessary that the prudential norms be reviewed by the RBI, taking into account the international norms, and the norms applicable to the commercial banks in India as also the general economic climate in the country. The RBI should prescribe ceilings for exposure to the real estate sector and also investment in capital markets specially unquoted shares. The exposure norms for exposures to connected companies need to be tightened. These measures are essential to prevent deployment of public deposits in high risk and speculative avenues. The RBI may stipulate that the NBFCs should invest atleast 25% of their reserves in marketable securities apart from the SLR securities already held by the NBFCs.

7. The need for regulations on the deposit taking activities of NBFCs has basically arisen because of the information asymmetry that exists between an uninformed depositor and the NBFC. Further, deposits raised from the public are more likely to be of short term duration, resulting in maturity mismatches between asset and liability and the attendant risks. Linking of the quantum of public deposits with credit rating, however, presents a different set of issues. Apart from having the effect of conferring regulatory functions on the rating agencies, it also exposes the NBFCs to frequent asset liability mismatches arising out of changes in credit rating. in view of the additional level of comfort provided by a credit rating, it is appropriate for the RBI to stipulte a higher ceiling for public deposit for those companies which have obtained rating for their instruments. However, for

reasons mentioned above, it may not be necessary to link the quantum of deposit to the rating per-se provided the rating is above the minimum investment grade. In summary, the proposed ceiling could be as under:—

Type of Company	Limit of Public Deposits
NBFC with NOF less than Rs. 25 lacs	No access to public deposits
EL/HP company without credit rating	1.5 times NOF or Rs. 10 crores which ever is lower. (higher CRAR of 15%)
EL/HP company with investment grade credit rating or above	4 times NOF
Loan/Investment companies with investment grade credit rating or above	1.5 times NOF (higher CRAR OF 15%)

8. The RBI should consider measures for easing the flow of credit from banks to NBFCs and then consider prescribing a suitable ratio as between secured and unsecured deposits for NBFCs.

9. The liquid asset ratio should be increased to 25% of public deposit from the present level in a phased manner. By a suitable statutory provision, the unsecured depositors may be given a first charge on these liquid assets so that an unsecured depositor is atleast assured of a return of one-out-of-every-four-rupees deposited by him.

10. The RBI can be statutorily empowered to appoint depositors' grievance redressal authorities with specified territorial jurisdiction. The office of the Banking Ombudsman, could be a viable option for such appointments. This will also entail amendments in the RBI Act.

11. If the grievance is a one off problem, a fraction of the deposit equivalent to ratio of the liquid assets to the total public deposits may be paid to the depositor directly under the orders of this authority. As regards the balance payment, this authority may pass a suitable order.

12. To provide legal strength to the order of such authority, the order could be transmitted by this authority to the principal civil court of the District in which the registered office of the company is situated or to such competent principal civil court as desired by the depositor and such an order would be enforceable as a decree of such principal court.

13. Till such time as the amendments for setting up depositors' grievances redressal authorities are carried out, it is essential that the CLB tightens its procedures for dealing with complaints of depositors and puts in place a mechanism for speedly disposal of these complaints. The regional offices of the RBI and the regional offices of the CLB should set up a coordination mechanism to ensure that defaulting companies are speedily dealt with for violation of any regulatory/ statutory requirements.

14. State Governments may set up cells at the state and district level to help disseminate information relating to procedure for redressal of depositors' grievances.

15. The procedure for the liquidation of NBFCs should be substantially on line with those available for banks, so that these proceedings can quickly be brought to completion and the claims of various depositors and other creditors are settled as early as possible.

16. There is an imperative need for reviewing the particulars given in advertisements. Dues from the group companies, the business ventures in which the directors are interested and the

amount of exposure including the non-fund based facilities provided to such entities should also be included in the advertisement.

17. There is a need for the RBI to continue to take more intensive measures for a sustained depositors' awareness campaign. These publicity campaigns should be through print and electronic media, seminars, conferenes, etc. Associations of NBFCs and various investors' fora such as Consumers' Education Research Centre, Investors' Grievances Forum, Depositors' Associations, etc. should also be actively involved in these campaigns.

18. It would not be judicious to introduce a deposit insurance scheme for the depositors in NBFCs because of the moral hazard issues, likelihood of asset stripping and the likely negative impact on the growth of a healthy NBFC Sector.

19. A separate instrumentality for regulation and supervision of NBFCs under the aegis of the RBI should be set up. It should have representation of experts and other professionals and should help the overall supervisory policies of the RBI. Rules and regulations for the new instrumentality should provide enough flexibility for induction of sepcialists and experts with requisite supervisory skills. The RBI should have a separate Executive Dirsector for this purpose, supervised by a Deputy Governor, so that there is greater focus in regulation and supervision of the NBFC sector.

20. RBI could use the services of chartered accountants with suitable experience and capabilities to carry out inspections of the smaller NBFCs.

21. The offsite surveilance mechanism should pick up any significant spurt in NPAs and any bunching of repayment of deposits.

22. it is important to have a very sensitive market intelligence system which could trigger onsite inspections followed by appropriate regulatory responses.

23. The RBI should be vested with powers to direct a particular NBFC or a class of NBFCs to seek prior approval of the RBI before appointing its statutory auditors.

24. Wherever the RBI has reasons to believe that the management of an NBFC is likely to indulge in fraudulent activities to the detriment of the company or its depositors, the RBI may notify such company and on notification, the assets of the company shall stand attached and the management of the assets be vested with a custodian to be appointed by the RBI. The assets may then be disposed off under the orders of a special court or of a High Court to be notified as a special court for this purpose. Suitable amendments may be made in the RBI Act to put in place such an arrangement.

25. The amendment to the RBI Act in 1997 is a step in the right direction and allowing access to deposits from individuals to such entities exposes the depositors to grave risks. However, there is a case for allowing them to have access to loans other than public deposits. They could be permitted to access loans from bodies with a corporate indentity, including NBFCs.

26. Deposit taking by unregistered NBFCs or NBFCs whose applications for certificate of registration have been rejected or whose registration has been cancelled or who have been prohibited from accepting deposits should be made a cognizable offence. State Governments should set up special investigation wings for enforcing these provisions.

27. The offence of unauthorised deposit taking by unicorporated financial intermediaries should be made cognizable. State Government should also expeditiously consider enacting legislation on the lines of the legislation enacted by Tamilnadu Legislature on this issue.

28. There should be a ban on issue of advertisements soliciting deposits by all unincorporated bodies.